

The Manufacturers Hanover Financial Digest

Economic Commentary,
Selected Financial Data,
and Business Indicators

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Recent Business And Price Trends . . .

With autumn about to unfold in the northern hemisphere, the strength of the sun's rays may not be the only thing diminishing. According to some, so, too, are prospects for more monetary policy ease. This is because with scattered indications of a pickup in business activity emerging both here and abroad, selected precious metals prices moving sharply higher and money supply growth accelerating, some financial market participants believe that the need for, and desirability of more ease have faded—and that interest rates have nowhere to go but up.

On the other hand, some argue the opposite. According to this view, the economy remains hobbled by lofty inflation-adjusted interest rates and a massive trade deficit, inflation is dormant despite the recent runup in gold, platinum and oil prices and the year-to-date growth of the broader money supply numbers, while picking up, does not yet warrant a tough Federal Reserve response. To these observers, the central bank still possesses considerable flexibility in setting the future course of monetary policy, with recent developments only diminishing the urgency with which more ease needs to be applied, not eliminating its eventual necessity.

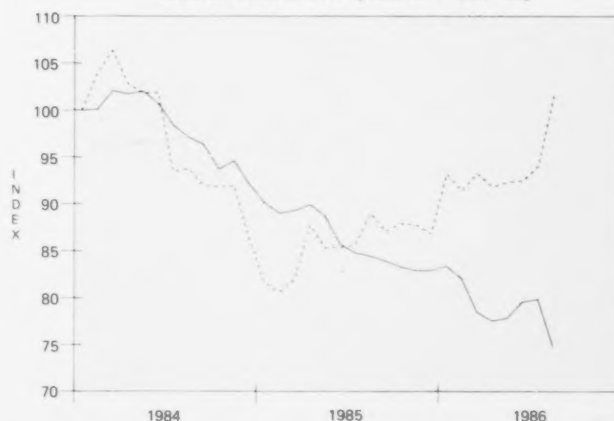
To be sure, whatever the outcome, the thrust of monetary policy will hinge on the strength of the economy—and here the debate begins. For after being swamped by an almost nonstop string of lackluster economic statistics in recent months, something seemed to change in August. The pace of business apparently quickened as evidenced by the hefty jump in total nonfarm employment and strong month-end gains in automobile and back-to-school retail sales. Since factory orders have also begun to exhibit some vigor and the index of leading economic indicators continues to point higher, this was enough proof for some that the long-awaited economic rebound was underway, and that the need for additional monetary policy stimulation had correspondingly diminished.

. . . Have Prompted Misplaced Concerns . . .

With regard to the economy at least, this view may not be far from the mark. The areas of weakness so

much in evidence in the second quarter should indeed be less of a drag on growth in subsequent quarters. As auto stocks move into better alignment with sales, inventory workdowns in this key sector will moderate; with oil prices rebounding from the depths reached in early July, the worst of the cutbacks in the "oil patch"—especially those six states which account for three quarters of domestic petroleum output—may be over. If so, then the top-line, GNP growth rate should rebound from the anemic, 0.6 percent annual rate of rise posted in the second quarter.

TUESDAY SPOT PRICE INDEX — RAW INDUSTRIALS (LINE) VS.
PRICE OF GOLD (DOT) <JANUARY 1984=100>



What may be wide of the mark, however, is the view that this automatically implies that the Fed will begin to back away from its accommodative policy stance. For there are several big obstacles to a surge in economic activity, and sufficient areas of weakness to ensure that monetary policy remains quite easy. For one thing, although the pace of imports is expected to slow at some point in response to the lower-valued dollar in the foreign exchange markets, it hasn't yet. The trade deficit remains huge, restraining economic activity in general, and the manufacturing sector in particular. For another, the uncertainties associated with proposed tax reform legislation, not to mention sizable chunks of idle capacity existing throughout the economy, will continue to inhibit capital spending. While consumption and residential construction may be strong, the production side of the economy isn't—ensuring



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only moderate growth at best, and ever present fears of no growth at worst.

If undue market concern about today's business conditions is misplaced, even more so is the fear of an imminent surge in the inflation rate. As shown in the chart on page 1, the recent runup in such precious metals prices as gold and platinum has had little affect on anything else, and commodity price inflation remains nonexistent. Industrial raw materials prices, for example, have declined at a better than 13 percent annual rate during the most recent three months, and now stand some 26 percent below this cycle's, March 1984 peak. Nor do labor costs—which account for some two-thirds of all manufacturing costs—present any threat to

today's tranquil price environment. Labor costs per unit of output in the manufacturing sector were virtually unchanged in the second quarter compared with the first, and over the past year have increased by only 1.3 percent. While unit labor costs in the entire private business sector advanced at twice this rate over the past year, the fact remains that price developments tend to belie the belief that a vigorous business rebound is underway and that inflation is reviving—the one-two punch which would produce a change in Fed policy.

... About The Stance Of Monetary Policy

What may be reviving are concerns about money growth. Although the torrid growth of the M1 money supply has been ignored all year long, a new

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/10/86	% Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	195.223	+ .916	+ 15.884
Loans to Depository Inst.	1.251	+ .280	+ .160
Float	.853	+ .339	+ .069
Total Reserve Bank Credit	213.473	+ 1.559	+ 19.894
Treasury Deposits with			
Federal Reserve Banks	3.424	+ 1.329	— .366
Currency in Circulation	202.514	+ .515	+ 13.147
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	159.199	— .952	+ 31.588
Member Bank Reserves:	9/10/86		
Total Reserves Held	51.484	+ .983	+ 7.895
Excess (Deficiency)	.752	— .121	+ .080
Net Free Reserves	.233	— .245	+ .284
Monetary Aggregates †		% Change Since	
		Three Months Ago*	Year Ago
M1 (9/1/86)	693.0	+ 17.6‡	+ 13.7‡
M2 (August '86)	2,722.5	+ 11.0	+ 8.2
M3 (August '86)	3,398.7	+ 10.0	+ 8.6
Domestic Nonfinancial Debt (1st Q'86)	7,033.5	+ 8.7	+ 14.2

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 9/12/86	3 Months	6 Months	1 Year
# U.S. Treasury Bills	5.20%	5.35%	5.47%
* Federal Agencies	5.43	5.46	5.60
* Municipal Notes—High Grade (46% Taxable Equivalent)	7.41	7.59	7.78
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	5.72	5.77	6.10
# Finance Company Paper—Prime		‡ Bankers' Acceptances	
5- 14 days	5.75%	Oct.	5.65%
15- 29 days	5.75	Nov.	5.60
30- 59 days	5.75	Dec.	5.60
60- 89 days	5.73	Jan.	5.60
90-179 days	5.65	Feb.	5.60
180-239 days	5.35	Mar.	5.55
240-270 days	5.35		
# Industrial Paper—Prime		† Federal Funds Effective Rate	
30- 89 days	5.72%		5.80%
90-120 days	5.69		

Discount basis.

* Subject to availability.

† Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'86	\$ 4,180	\$ 4,149	\$ 3,965
Gross National Product (1982 Dollars)*	2nd Q'86	\$ 3,662	\$ 3,656	\$ 3,568
Percent Change, Annual Rate	2nd Q'86	0.6	3.8	2.3
Change in Consumer Prices*	Jul '86n	0.0%	6.0%	2.4%
Change in Producer Prices*	Aug '86n	3.6%	— 4.8%	— 3.6%
Civilian Employment (Thousands of Persons) †	Aug '86n	110,155	109,882	107,210
Unemployment as % of Civilian Labor Force †	Aug '86n	6.8%	6.9%	7.1%
Personal Income*	Jul '86	\$ 3,502	\$ 3,487	\$ 3,315
Leading Indicators Composite Index (1967=100) †	Jul '86	179.4	177.4	169.2
Industrial Production Index (1977=100) †	Jul '86	124.1	124.2	124.1
Change in Consumer Installment Credit †	Jul '86n	\$ 5.38	\$ 5.39r	\$ 6.79
U.S. Merchandise Trade Balance	Jul '86	— \$ 18.04	— \$ 13.25	— \$ 13.58
Plant and Equipment Expenditures*	4th Q'86n	\$383.99(a)	\$380.52(a)r	\$397.88r
Private Housing Starts (Thousands of Units)*	Jul '86	1,818	1,852	1,673
New Construction Expenditures*	Jul '86n	\$ 376.7	\$ 374.8r	\$ 355.1
Total Business Inventories †	Jun '86	\$ 589.0	\$ 586.7	\$ 580.1
Total Business Sales †	Jun '86	\$ 423.6	\$ 421.6	\$ 418.2

*Seasonally adjusted annual rate.

†Seasonally adjusted.

n-Newly reported figure.

r-Revised.

a-Anticipated.

wrinkle was added in recent months in light of the pickup in the growth rate of the M2 and M3 money numbers. In July, for example, M2 rose at a better than 12 percent annual rate while M3 was up at a 13½ percent annual clip; over the past three months, each has been expanding at double-digit annual rates. While some have felt for a long time that rapid money growth was the Achilles' heel in the longer-term inflation outlook, even here, the likely response is uncertain. This is because the year-to-date growth of M2 is still within the 1986 target boundaries, while that of M3 is only a shade above its upper-target boundary. Indeed, it appears a good bet that as long as a large overshoot of the growth targets for these aggregates does not materialize, the Fed will not move aggressively to rein in the growth of the money supply.

Much the same can be said for the dollar. As with faster money growth, the inflation rate dangers of a rapidly declining dollar in the foreign markets have been repeatedly cited. But not only have these fears been slow to materialize, they have yet to deter the Fed from pursuing its course of monetary ease. Nor should they in the future. In fact, dollar considerations may even hasten efforts to pull lower the lofty level of real interest rates, given the huge trade deficit and the likelihood that further dollar depreciation will be necessary if this gap is too narrow (Financial Digest—August 29, 1986). If so, what all this adds up to is that misplaced concerns notwithstanding, the Fed has several good reasons for not only keeping policy accommodative, but easing further, if and when it deems such actions appropriate.

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Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since	
		Week Ago	Year Ago
Time Deposits of \$100,000 or more			
Weekly Reporting Banks			
Nationwide (8/27/86)	155,344	+ 336	- 1,232
New York City (9/3/86)	32,608	- 621	- 7
Commercial Paper (9/3/86)	321,858	+ 522	+47,904

Bank Loans

(Millions of Dollars)

Weekly Reporting Large Commercial Banks

	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (8/27/86)	256,726	+ 690	+ 3,462
New York City (9/3/86)	57,755	+ 880	- 2,996

Commercial and Industrial Loans

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (8/27/86)	739,551	+ 1,976	+ 52,991
New York City (9/3/86)	160,542	+ 2,953	+ 5,887

Financial Markets

	Friday 9/12/86	Change Since	
		Week Ago	Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.28%	- .07	- 2.19
180-Day Bills†	5.58	+ .09	- 2.21
Longest Bills†	5.73	+ .06	- 2.45
Recent Issues:			
6½/8S 8/31/88	6.46	+ .25	
7½/4S 6/15/90	7.03	+ .57	
7¾/8S 5/15/96	7.60	+ .30	
7½/4S 5/15/16	7.73	+ .19	
Municipals:			
Bond Buyer—20 Bond Index* (9/11/86)	7.15%	+ .15	- 1.92
Blue List Total (\$ Million)	\$1,663	+\$ 74	- \$ 107
30-Day Visible Supply (\$ Million)	\$2,016	+\$1,011	- \$2,378
Total	\$3,759	+\$1,085	- \$2,485
Corporates:			
Moody's Aa Composite (9/11/86)	9.39%	+ .14	- 1.96
30-Day Visible Supply (\$ Million)	\$1,883	-\$ 96	- \$ 407
Stocks:			
Dow-Jones Averages:			
Industrials	1,758.72	-141.03	+ 423.03
Transportation	737.38	- 40.12	+ 59.83
Utilities	198.78	- 14.93	+ 39.62
65 Stocks	685.29	- 49.65	+ 133.76
N.Y.S.E. Composite Index	132.81	- 11.08	+ 23.76
N.Y.S.E. Avg. Daily Vol. for Week (000's)	182,192	+17,232	+ 93,029

International Rates

	Friday 9/12/86	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	5.81%	5.69%
1 month	5.88	5.81
3 month	5.88	5.75
6 month	5.88	5.75
1 year	6.13	5.88
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	7.58%	7.37%
Long Term (7 to 15 yrs.)	8.27	7.91
FOREIGN EXCHANGE SPOT RATES		
New York Opening (9/12/86)	U.S. \$ Equivalent	Currency Per U.S. \$
Belgium	.02378	42.05
Canada	.7206	1.3878
Denmark	.1269	7.8825
France	.1471	6.8000
Germany	.4810	2.0788
Italy	.0006981	1432.50
Japan	.006429	155.55
Mexico	.001355	738.00
Netherlands	.4271	2.3415
Switzerland	.5876	1.7018
U.K.	1.4705	.6800

* 46% Taxable equivalent 13.24%.

† Bond equivalent.



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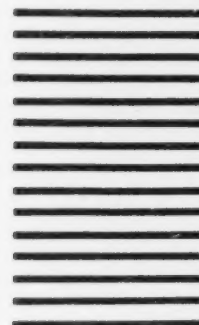
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